



School and Institutional Trust Funds Office FY 2022 Budget Request

SITFO Background

In 2014, the Legislature created SITFO as an independent state agency with an expert five-member board of trustees, chaired by the state treasurer, to invest the funds produced by SITLA's administration of the land. SITFO was established at the recommendation of a task force comprised of Utah investment professionals, who recognized that a multibillion-dollar portfolio is best managed by a dedicated team of experienced professionals.

SITFO commenced operations in September 2015. Prior to this time, the budget was developed in abstract by an indirect set of participants. In the first five years of operations, SITFO has taken a pragmatic approach to methodically build out the necessary resources to a best-in-class effort, while being mindful of costs. SITFO is currently budgeted for 4.5 FTE and utilizes outside investment advisors and fund managers to implement a fully diversified, long-term oriented investment strategy.

Budget Request Summary

In 2019, SITFO hired an organizational consultant to work with its trustees to provide support for the next stage of the agency's development. Based on this research, SITFO is requesting funds to add 6.5 FTE, increasing the team to 11 professionals. The total budget required to sustain this organizational improvement is \$3,286,886. The agency's current budget is \$1,423,200, necessitating an additional \$1,863,686.

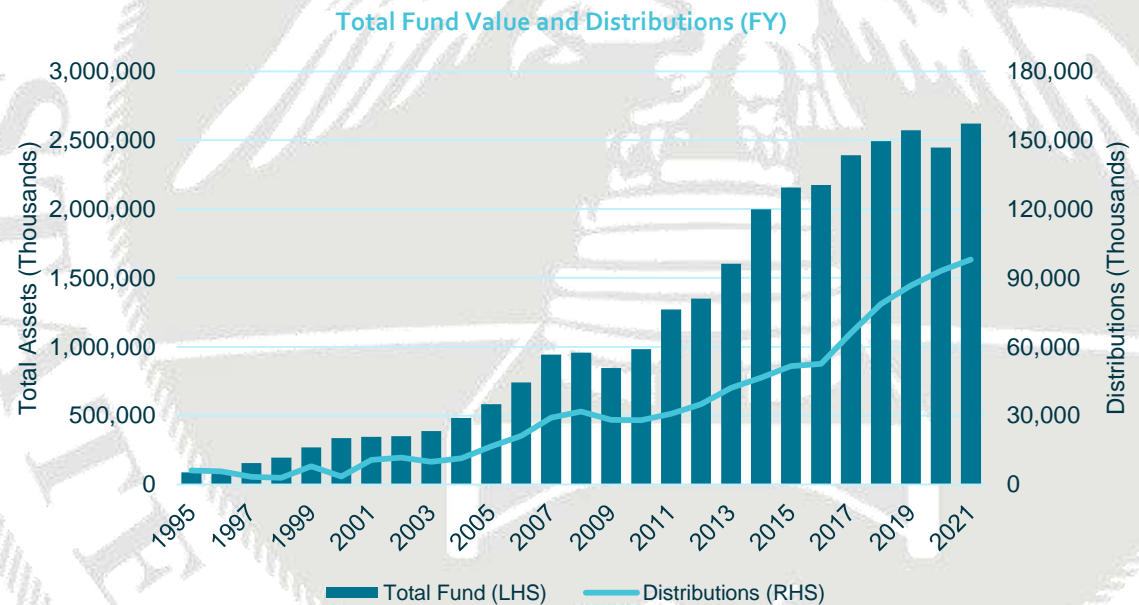
SITFO is supported by funds from the trusts it manages. It is not supported by tax revenues. Given the source of funding for the budget is the investment earnings of the underlying trusts, the industry standard for reflecting on these amounts is to consider them as a proportional expense in relation to the total assets managed. In this framework, the requested budget represents an expense of 0.12%.

Transitioning to Endowment Model

HB 168 (2014), which passed unanimously in both the House and Senate, and Constitutional Amendment B (2016) were enacted to achieve an over-arching objective to transition the Permanent State School Fund, its distributions, its asset allocation, and its management and oversight into the endowment model.

The endowment model focuses on reducing portfolio volatility through diversification into alternative investments such as private equity and private real estate. Alternatives require a higher level of resources to manage given the increased need for due diligence and monitoring.

Reductions in portfolio volatility under the endowment model correspond with *reductions in volatility of distributions* from the portfolio, providing beneficiaries with greater certainty of expected resource. Annual distributions have roughly doubled over the five fiscal years since SITFO was created. Based on the complexity of private asset classes and their sourcing, selection, and implementation, re-engineering of the portfolio is expected to take several years.



The increased complexity requires increased resources. Staffing these highly specialized and skilled functions requires relatively high-wage positions. SITFO is requesting the addition of 6.5 FTE, increasing the team to 11 professionals and a total budget of \$3,286,886, which brings it closer to industry standard expenses.

From an organizational aspect, the additional team members are necessary to provide resiliency to the agency. With SITFO's current staffing of 4.5 FTE, any turnover creates significant setbacks and introduces unnecessary risk to the portfolio. Turnover on a team of SITFO's current size amplifies the loss of institutional knowledge, slows momentum, and magnifies the general burdens inherent to employee attrition.



Staffing Comparisons

The expenses currently allocated to managing the portfolio are low relative to SITFO's peers. SITFO's approach to managing costs strikes a balance between investing in the highest quality to achieve desired outcomes, while also exercising the prudence required of a fiduciary and limiting unnecessary expenses.

Peer institutions are led by internal staff and have an average of seven investment professionals and four other professionals. SITFO's planned organizational structure anticipates seven investment professionals and four risk, operations, and accounting related professionals.

Insourcing versus Outsourcing

The proposed budget request is anticipated to save money in the long-term, as utilizing internal staff is less expensive than outsourcing to third parties.

SITFO has modeled the costs of adding personnel to the agency versus hiring third parties and estimates that insourcing would result in long-term cost savings of between \$4 million and \$8 million annually. Insourcing also carries the benefits of adding jobs in Utah, providing a higher degree of customization, and improving the resiliency of the agency.

If the proposed budget request is not approved, the SITFO board of trustees would outsource the necessary resources, which would increase overall trust expenses.

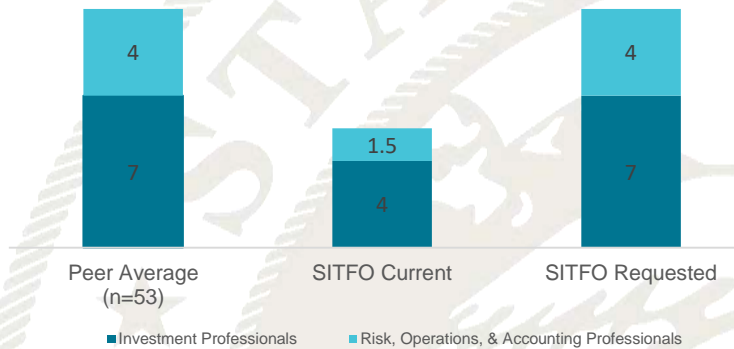
SITFO consultants recommended the insourcing alternative to the board of trustees.

Industry peers, such as Utah Retirement Systems, are likewise pursuing a similar insourcing strategy for many of the same reasons.

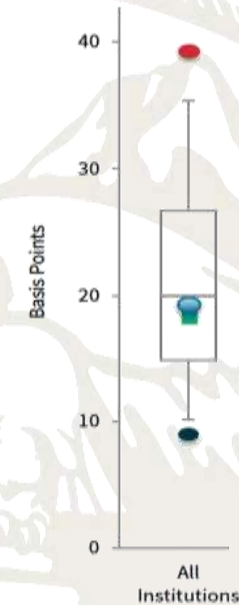
Asset Allocation Changes

Based on a recent asset allocation study performed by SITFO and its consultants, the board of trustees recently approved changes to the asset allocation, which will increase exposure to private asset classes, requiring significantly more internal resources. These changes are designed to enhance return and reduce risk through diversification.

Investment Office Staff Size



Total Oversight Costs



Reasonable Investment Oversight Expenses

The chart below highlights the balance between spending too little and too much on investment oversight and the likelihood of providing sufficient versus insufficient resources for prudent management.

SITFO's current expenses fall in the range of "spending too little," while the proposed budget request falls in the "reasonable range." This is supported by the chart to the right, which shows that the budget request will put the organization in-line with peer institutions in terms of financial resources.



Source for peer data: Cambridge Associates LLC Investment Office Organization and Governance Survey

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